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NOT TO BE PUBLISHED IN OFFICIAL REPORTS

IN THE COURT OF APPEAL OF THE STATE OF CALIFORNIA

FIRST APPELLATE DISTRICT

DIVISION FIVE

PROSPER MARKETPLACE, INC., **Plaintiff and Respondent,** **v.** **GREENWICH INSURANCE COMPANY,** **Defendant and Appellant.**	**A132967** **(San Francisco City & County Super. Ct. No. CGC-09-491736)**

Plaintiff/respondent Prosper Marketplace, Inc. (Prosper), sought insurance coverage from its insurer, defendant/appellant Greenwich Insurance Company (Greenwich), for an underlying securities class action; Greenwich denied coverage and refused to defend. Following a bench trial solely on the issue of the duty to defend, the court concluded Greenwich had a duty to defend the underlying action up to the limits of its policy. Greenwich appeals the stipulated final judgment, contending the policy's errors and omissions exclusion bars coverage of the underlying action. We reject the contention and affirm.

BACKGROUND

The Underlying Action

On November 26, 2008, Prosper and certain of its directors and officers were sued in a class action, *Hellum v. Prosper Marketplace, Inc.* (Super. Ct. S.F. City and County No. CGC-08-482329) (*Hellum*), alleging claims for violation of California and federal

securities laws.[1] The original *Hellum* complaint alleged the following: The plaintiff class consisted of "all loan note purchasers in [Prosper's] online lending platform through Prosper's website . . . from January 1, 2006 through October 14, 2008." Through the online lending platform on its website, Prosper connected "borrowers" who wanted to borrow money with "lenders" who wanted to commit to purchase loans in the form of loan notes that had been extended to borrowers.[2] Lenders and borrowers registered on Prosper's website without disclosing their actual identities. Borrowers requested unsecured loans in amounts between $1,000 and $25,000 by posting "listing[s]" on the website. Prosper assigned borrowers a credit grade based on commercial credit scores obtained from a credit bureau. Potential lenders bid on funding all or portions of loans for specified interest rates, which were typically higher than rates available from depository accounts at financial institutions. After an auction closed and a loan was fully bid upon, the borrower received the requested loan with the interest rate fixed by Prosper at the lowest rate acceptable to all winning bidders. The individual lenders did not actually lend money directly to the borrower; instead, the borrower received a loan from a bank with which Prosper had contracted. Interests in the loan were then sold and assigned by Prosper to the lenders, with each lender receiving an individual "non-recourse" promissory note.[3] In return, Prosper collected an "origination fee" from each borrower of 1 to 3 percent of the loan proceeds, and collected "servicing fees" from each lender from loan payments at an annual rate of 1 percent of the outstanding balance of the

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[1] After Greenwich denied Prosper's tender of defense of *Hellum*, the *Hellum* plaintiffs filed a second amended and operative complaint (SAC). As necessary, the background facts refer to both the *Hellum* original complaint and the SAC. Greenwich acknowledges that the SAC contains all of the material allegations included in the original *Hellum* complaint and argues neither the original complaint nor the SAC triggered its duty to defend Prosper.

[2] In the *Hellum* complaint, the class action plaintiffs are variously referred to as the "loan note purchasers" and "the lenders."

[3] The *Hellum* complaint does not allege that Prosper guaranteed or was otherwise liable for the loans.

notes. Prosper also administered the collection of loan payments from the borrowers and the distribution of such payments to the lenders.

The *Hellum* complaint alleged that on November 24, 2008, the federal Securities and Exchange Commission (SEC) issued an "Order Instituting Cease-and-Desist Proceedings Pursuant to Section 8A of the Securities Act of 1933, Making Findings, and Imposing a Cease-and-Desist Order" (SEC Order).[4] The SEC Order found that the loan notes were securities pursuant to the federal Securities Act of 1933 (1933 Act) (15 U.S.C. § 77a et seq.), and that Prosper violated sections 5(a) and 5(c) of the 1933 Act by offering to sell and selling the loan notes without an effective registration statement.

The *Hellum* complaint alleged the following five causes of action: a claim for violation of (1) Corporations Code sections 25110 and 25503 that alleged Prosper offered to sell and/or sold the loan notes which were unqualified securities; (2) Corporations Code section 25504 that alleged the individual defendants materially aided Prosper in offering and selling the loan notes; (3) Corporations Code sections 25210 and 25501.5 that alleged Prosper sold securities as an uncertified broker-dealer; (4) section 12(a)(1) of the 1933 Act that alleged Prosper's sale of the loan notes was a sale of unregistered securities; and (5) section 15 of the 1933 Act that alleged the individual defendants were control persons of Prosper who could have known the loan notes were not sold or offered pursuant to an effective registration statement.

On July 10, 2009, the *Hellum* SAC was filed. It alleged the following, in relevant part: "Prosper's sole business was to offer and sell unregistered and unqualified loan note securities to Plaintiffs and the Class." Loans posted before April 15, 2008, were made directly by Prosper from its funds to borrowers. Prosper then sold and assigned the loans to lenders through the auctions. For loans posted after April 15, 2008, individual lenders did not actually lend money directly to the borrower; the borrower received a loan from WebBank, with which Prosper had contracted. The loans were subsequently sold and assigned by WebBank to Prosper, and Prosper then sold and assigned the loans to

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[4] The SEC Order was attached to both the *Hellum* original complaint and the SAC.

lenders. Each lender purchasing a loan from Prosper received an individual non-recourse promissory note. Prosper had the "sole contractual right to service the loans, including administering borrower and lender accounts, providing monthly statements that reflect[ed] payments made and received on the loan notes, as well as amounts available for bidding on new notes." Prosper also had the "sole right to act as loan servicer of the notes. In this capacity Prosper collect[ed] loan principal and interest payments and distribute[d] them to lenders, contact[ed] delinquent borrowers to encourage loan repayment, and report[ed] loan payments and delinquencies to credit reporting agencies." "Prosper controlled and provided information to prospective lenders about loan note listings to enable lenders to make informed investment decisions. . . . The information Prosper provided to prospective loan note purchasers, however, was insufficient for the purposes for which it was offered and did not include important disclosures that were required in order to offer and sell the loan notes [as] securities."

The *Hellum* SAC contained the five causes of action in the original complaint and added the following two causes of action: a claim for violation of (1) Corporations Code sections 25130 and 25503 that alleged Prosper offered to sell and/or sold the loan notes, which were unqualified nonissuer securities; and (2) Corporations Code section 25504 that alleged the individual defendants were control persons of Prosper who offered to sell and/or sold the loan notes in violation of sections 25110, 25130, and 25503.

The Greenwich Policy

Prosper purchased from Greenwich, Private Company Reimbursement Insurance Policy No. ELU104916-08 with an effective period of May 26, 2008, to May 19, 2009 (the Policy). The Policy is a claims-made policy[5] that imposes the following broad

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5 "The difference between 'claims-made' and 'occurrence' policies has to do with the insured risk. Under a 'claims-made' policy, the insurer generally is responsible for loss resulting from claims made during the policy period no matter when the liability-generating event took place. Under an 'occurrence' policy, the insurer generally is responsible for loss resulting from acts that occur during the policy period, even if the claim is made after the policy expires. [Citations.]" (*Helfand v. National Union Fire Ins. Co.* (1992) 10 Cal.App.4th 869, 885, fn. 8.)

defense obligation on Greenwich: "The Insurer, has the right and duty to defend any Claim against any Insured covered under this Policy, even if such Claim is false, fraudulent or groundless." "Claim" is defined, in relevant part, as "any civil proceeding in a court of law or equity, or arbitration."

Prosper sought coverage from Greenwich for the *Hellum* action under the Policy's directors and officers (D&O) provision entitled "Management Liability and Company Reimbursement Coverage Part" (D&O Part).[6]

The insuring agreements of the D&O Part provide, in relevant part:

"(A) The Insurer shall pay on behalf of the Insured Persons Loss resulting from a Claim first made against the Insured Persons during the Policy Period . . . for a Wrongful Act, except for Loss which the Company[, Prosper,] is permitted or required to pay on behalf of the Insured Persons as Indemnification.

"(B) The Insurer shall pay on behalf of the Company Loss: [¶] (1) which the Company is required or is permitted to pay as indemnification to the Insured Persons resulting from a Claim first made against the Insured Persons; or [¶] (2) resulting from a Claim first made against the Company; [¶] during the Policy Period . . . ."

In relevant part, the D&O Part defines "Wrongful Act" as "any actual or alleged act, error, omission, misstatement, misleading statement or breach of duty by the Company" or "any Insured Person of the Company."

Within its "General Definitions" section, the Policy defines "Loss" as "damages, judgments, settlements or other amounts . . . that the Insured is obligated to pay, including Defense Expenses, whether incurred by the Insurer or the Insured." "Defense Expenses" are defined as "reasonable legal fees and expenses incurred in the defense of any Claim . . . ."

Greenwich asserts the "General Errors & Omissions Exclusion" (E&O Exclusion) to the D&O Part, attached to the Policy by an endorsement, bars coverage of *Hellum*.

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6 On its face, the Policy contains an $8.0 million maximum aggregate limit of liability. However, it is undisputed that for purposes of this appeal the Policy limit is $2.0 million.

The E&O Exclusion provides: "[N]o coverage will be available under [the D&O Part] for Claims based upon, arising out of, directly or indirectly resulting from, in consequence of, or in any way involving any actual or alleged act, error, omission, misstatement, misleading statement or breach of duty in connection with the rendering of, or actual or alleged failure to render, any services performed for others for a fee or commission or on any other compensated basis by any person or entity otherwise entitled to coverage under this Policy." The term "services" is not defined in the Policy.

The Instant Action

After Prosper tendered its defense of *Hellum* to Greenwich, Greenwich informed Prosper of its denial of coverage and refusal to defend. Greenwich initially based its denial on the E&O Exclusion; later it also asserted that the securities exclusion to the D&O Part barred coverage.[7] On August 31, 2009, Prosper filed its first amended complaint against Greenwich seeking a declaration that the Policy provides coverage for *Hellum* and alleging breach of contract and breach of the covenant of good faith and fair dealing. The parties stipulated to a bench trial on the bifurcated issue of Greenwich's duty to defend Prosper in *Hellum* up to the Policy's $2.0 million limit.

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[7] The securities exclusion to the D&O Part provides that Greenwich "shall not be liable to make any payment for Loss, and shall have no duty to defend or pay Defense Expenses, in connection with any Claim made against the Insured: [¶] . . . [¶] for any actual or alleged violation of the [1933 Act], the Securities Exchange Act of 1934, any state 'blue sky' securities law, or any other federal, state or local securities law, including any amendments thereto, or any rule or regulation promulgated thereunder or any similar common law imposing liability in connection with the offering, sale or purchase of securities of the Company. This EXCLUSION (I) shall not apply to any Claim arising out of the offering, sale or purchase of securities, whether debt or equity, in a transaction that is exempt from registration under the [1933 Act]." The securities exclusion is limited by endorsement to "only apply in the event: [¶] (a) there has been a public offering of stock of the Parent Company or any Subsidiary, or [¶] (b) there has been a public sale of debt securities issued by the Parent Company or any Subsidiary."

The trial court concluded the securities exclusion did not negate Greenwich's duty to defend because it applies only to public offerings of Prosper stock or the public sale of debt securities issued by Prosper. In its opening brief, Greenwich states it is relying solely on the E&O Exclusion as barring coverage of *Hellum*.

Following trial, the court issued a statement of decision concluding that the E&O Exclusion does not negate Greenwich's duty to defend *Hellum* and that Greenwich breached that duty by failing and refusing to reimburse Prosper and the individual defendants for the defense costs incurred in the action. The stipulated final judgment provided that Greenwich has a duty to defend Prosper in *Hellum* up to the $2.0 million policy limit and to pay Prosper $142,584.53 in prejudgment interest.

Greenwich filed a timely notice of appeal from the stipulated final judgment.

DISCUSSION

It is undisputed that the allegations in the *Hellum* original complaint and SAC give rise to a potential for liability for which Greenwich has a duty to defend under the D&O Part of the Policy. Greenwich contends the E&O Exclusion unambiguously excludes coverage for *Hellum* and, therefore, the trial court erroneously concluded that Greenwich has a duty to defend Prosper in that underlying action.

I. *Standard of Review and Insurance Law Principles*

" ' " '[A] liability insurer owes a broad duty to defend its insured against claims that create a potential for indemnity. [Citation.] . . . "[T]he carrier must defend a suit which *potentially* seeks damages within the coverage of the policy." [Citation.] Implicit in this rule is the principle that the duty to defend is broader than the duty to indemnify; an insurer may owe a duty to defend its insured in an action in which no damages ultimately are awarded. [Citations.]' [Citation.]" [Citation.]' . . . [Citation.]" (*Ortega Rock Quarry v. Golden Eagle Ins. Corp.* (2006) 141 Cal.App.4th 969, 977.) "[T]he insured is entitled to a defense if the underlying complaint alleges the insured's liability for damages *potentially* covered under the policy, or if the complaint might be amended to give rise to a liability that would be covered under the policy. [Citation.]" (*Montrose Chemical Corp. v. Superior Court* (1993) 6 Cal.4th 287, 299.) Thus, "to prevail on a duty to defend claim, an insured need ' " 'only establish that the underlying claim *may* fall within policy coverage . . . .' " ' [Citation.] Insurers have the more difficult burden of proving that the underlying claim *cannot* fall within policy coverage. [Citation.]"

(*Ameron Internat. Corp. v. Insurance Co. of State of Pennsylvania* (2010) 50 Cal.4th 1370, 1378 (*Ameron*).)

There is also "a duty to defend when the policy is ambiguous and the insured would reasonably expect the insurer to defend him or her against the suit based on the nature and kind of risk covered by the policy." (*Foster-Gardner, Inc. v. National Union Fire Ins. Co.* (1998) 18 Cal.4th 857, 869; *Lyons v. Fire Ins. Exchange* (2008) 161 Cal.App.4th 880, 885.) "If any facts stated or fairly inferable in the complaint, or otherwise known or discovered by the insurer, suggest a claim potentially covered by the policy, the insurer's duty to defend arises and is not extinguished until the insurer negates all facts suggesting potential coverage. On the other hand, if, as a matter of law, neither the complaint nor the known extrinsic facts indicate any basis for potential coverage, the duty to defend does not arise in the first instance." (*Scottsdale Ins. Co. v. MV Transportation* (2005) 36 Cal.4th 643, 655.)

"Appellate courts apply an independent standard of review to decisions interpreting, constructing, and applying insurance policies to determine the scope of actual or potential coverage. [Citation.] More specifically, '[w]hen determining whether a particular policy provides a potential for coverage and a duty to defend, we are guided by the principle that interpretation of an insurance policy is a question of law.' [Citation.]" (*Food Pro Internat., Inc. v. Farmers Ins. Exchange* (2008) 169 Cal.App.4th 976, 984-985.) We independently interpret an insurance policy's provisions under settled rules of contract interpretation. (*Ameron, supra,* 50 Cal.4th at p. 1377.) Our goal is to determine the mutual intention of the parties at the time the policy was created; and such intent should be inferred, if possible, solely from the written provisions of the policy. (*Id.* at p. 1378.) " ' "The 'clear and explicit' meaning of these provisions, interpreted in their 'ordinary and popular sense,' unless 'used by the parties in a technical sense or a special meaning is given to them by usage' [citation], controls judicial interpretation. [Citation.]" ' [Citation.]" (*Ibid.*) In order to ascertain the ordinary sense of words, courts in insurance cases regularly turn to general dictionaries. (*Scott v. Continental Ins. Co.* (1996) 44 Cal.App.4th 24, 29 (*Scott*).)

"An insurance policy provision is ambiguous when it is susceptible of two or more reasonable constructions. [Citation.] If ambiguity exists . . . , the courts must construe the provisions in the way the insurer believed the insured understood them at the time the policy was purchased. [Citation.] In addition, if, after the court evaluates the policy's language and context, ambiguities still exist, the court must construe the ambiguous language against the insurer, who wrote the policy and is held ' "responsible" ' for the uncertainty. [Citation.] Particularly, '[i]n the insurance context, . . . ambiguities [are resolved] in favor of coverage' so as to protect the insured's reasonable expectation of coverage. [Citations.]" (*Ameron, supra,* 50 Cal.4th at p. 1378.)

" 'In addition to the general contract interpretation rules, there are special rules applicable to exclusions. [Citation.] Thus, although the insured has the burden of proving the contract of insurance and its terms, the insurer bears the burden of bringing itself within a policy's exclusionary clauses. [Citations.] Further, exclusionary clauses are strictly construed against the insurer and in favor of the insured. [Citations.] Thus, any provision that takes away or limits coverage reasonably expected by the insured must be "conspicuous, plain and clear" to be enforceable. [Citations.]' [Citations.]" (*North American Building Maintenance, Inc. v. Fireman's Fund Ins. Co.* (2006) 137 Cal.App.4th 627, 642 (*NABM*).) An insurer must clearly state any exceptions to coverage; courts are not to insert what has been omitted. (*Safeco Ins. Co. v. Robert S.* (2001) 26 Cal.4th 758, 763-764.) " 'If an exclusion ambiguously lends itself to two or more reasonable constructions, the ambiguity will be resolved against the insurer and in favor of coverage.' [Citation.]" (*Morris v. Employers Reinsurance Corp.* (2000) 84 Cal.App.4th 1026, 1029 (*Morris*).)

At issue here is the E&O Exclusion to the D&O Part of the Policy. "D&O insurance is 'a specialized form of coverage for (i) claims against corporate directors and officers based on acts committed in their corporate capacities; [and] (ii) the corporation's indemnification obligations to its directors and officers for such claims . . . .' " (*August Entertainment, Inc. v. Philadelphia Indemnity Ins. Co.* (2007) 146 Cal.App.4th 565, 573

(*August*).)[8] "One of the primary purposes of a D&O policy is to protect directors and officers from individual liability for suits . . . arising out of the business decisions that they must make in their management capacity." (See *Fed. Ins. Co. v. Hawaiian Electric. Industries, Inc.* (D. Hawaii, Dec. 23, 1997, C94-00125 HG) 1997 Lexis 24129 [p. *33; nonpub. opn.]) (*Hawaiian Electric*). The availability of D&O insurance is important in attracting people to serve as corporate directors and officers. (*August*, at p. 574.)

" '[U]nlike general liability insurance, which is typically written on standard forms, D&O policy provisions often vary depending on a number of factors, including the nature of the insured's business, the insured's financial condition, and [the] insured's status as a public or private company. Cases must therefore be reviewed in the context of the specific policy language at issue. . . .' [Citations.]" (*August, supra*, 146 Cal.App.4th at pp. 573-574.)

II. *The E&O Exclusion Does Not Bar Coverage of the Hellum Claims*

The issue presented is whether Greenwich has established that *all* of the *Hellum* claims against Prosper and the individual defendants arise out of an act in connection with rendering or failing to render services for others for a fee and are, therefore, barred from coverage by the E&O Exclusion.[9]

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[8] Since there are few California cases concerning D&O policies, " 'California courts often look to decisions of California federal courts and out-of-state cases in resolving coverage issues and interpreting policy provisions' [Citations.]" (*August, supra*, 146 Cal.App.4th at p. 577.)

[9] Although D&O policies often contain "professional services" exclusions which exclude losses in connection with claims against directors and officers alleging or arising out of any act, error or omission by an insured in connection with rendering or failing to render professional services (Croskey et al., Cal. Practice Guide: Insurance Litigation (The Rutter Group 2011) ¶ 7:1717.2, p. 7F-56 (rev. #1, 2011); see also 4 New Appleman Insurance (Law Library ed. 2011) § 26.07[2], p. 26-34 (rel. 6-12/2011)), the E&O Exclusion here excludes loss in connection with claims against Prosper and its officers and directors arising out of rendering or failing to render "services." Generally, the parties do not distinguish between professional services exclusions and services exclusions and rely solely on cases concerning professional services exclusions. However, Greenwich asserts in its reply brief that a case relied on by Prosper is "unpersuasive" and "inapposite" because it construes an errors and omissions exclusion

A. *The Plain Language of the Exclusion Does Not Bar Coverage of the* Hellum *Claims*

Greenwich contends that *all* of the claims in *Hellum* concern alleged acts, errors or breaches committed by Prosper " 'in connection with the rendering of, or actual or alleged failure to render . . . services performed for others for a fee or commission or on any other compensated basis' " and are, therefore, barred by the plain language of the E&O Exclusion. In particular, Greenwich argues that the following allegations of the SAC assert "services performed for others" by Prosper "in connection" with Prosper's sale of the loan notes:

"9. . . . Prosper's Marketplace works like a double-blind auction, connecting 'borrowers' who wish to borrow money, with 'lenders,' like Plaintiffs, who wish to commit to purchase loans in the form of loan notes, that have been extended to borrowers."

"10. Lenders and borrowers register on [Prosper's] Website and create Prosper identities through 'screen names'."

"12. Prosper assigns borrowers a credit grade based on [a] commercial credit score that it obtains from a credit bureau . . . ."

"18. Loans posted after April 15, 2008 were made by WebBank and then subsequently sold and assigned by WebBank to Prosper, which in turn sold and assigned such loans to lenders."

"19. Each lender purchasing a loan from Prosper receives an individual non-recourse promissory note."

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limited to "professional services," rather than "any services." Given Greenwich's reliance on cases involving "professional services," this assertion seems disingenuous. Our independent research has found a single case construing an errors and omissions exclusion to a D&O policy regarding rendering or failing to render "services." (See *Fleming Fitzgerald & Associates Ltd. v. U.S. Specialty Ins. Co.* (W.D.Pa., Sept. 30, 2008, No. 70-1596) 2008 WL 4425845 [pp. *13-*15; nonpub. opn.] [claims in underlying action not based on rendering or failing to render services].) For purposes of our analysis here, the distinction between professional services exclusions and services exclusions is not significant.

Greenwich argues the following allegations of the SAC state that, in return for these alleged services, Prosper received compensation:

"8. For its loan underwriting and servicing, Prosper earned a fee calculated as a percentage of the total loan amount of each loan it underwrote."

"23. For its underwriting services, Prosper collects an origination and underwriting fee from each borrower of one to three percent of loan proceeds. Prosper also collects servicing fees from each lender from loan principal and interest payments at an annual rate of one percent of the outstanding balance of the notes."[10]

"40. . . . Prosper collected fees and commissions from both lenders and borrowers and collected additional commissions from its exclusive servicing of the loans. These fees and commissions were designed to generate a profit for Prosper."

Greenwich's arguments fail. The E&O Exclusion extends only to claims arising out of an act in connection with Prosper providing services to others for a fee. "Courts require a close connection between the provision of professional services and the underlying claim before they will deny coverage pursuant to a professional E&O exclusion." (*Great American Ins. Co. v. GeoStar Corp.* (E.D.Mich., Mar. 5, 2010, Nos. 09-12488-BC, 09-12608-BC, 09-14306-BC) 2010 WL 845953 [p. *10; nonpub. opn.] (*GeoStar*).) The parties agree that the gravamen of *Hellum* is that Prosper sold or offered to sell loan notes that were unregistered securities in violation of state and federal securities law. Even assuming the SAC alleges services performed for others for a fee or other compensation, the claims in *Hellum* do not appear to allege liability on the part of Prosper and the underlying defendants arising from an act or error in connection with providing these services.[11] Moreover, none of the *Hellum* claims appears to allege a deprivation of services provided for a fee. However, the claims asserted in *Hellum* do allege an "act" or "error" by Prosper and the underlying defendants in selling and/or

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[10] A similar factual allegation is included in the SEC order attached to the SAC.

[11] In each cause of action, the *Hellum* plaintiffs alleged Prosper and the underlying defendants were liable solely because the loan notes were unregistered securities.

offering to sell unregistered securities in violation of state and federal securities laws. Additionally, paragraphs 8, 23, and 40 of the SAC quoted above do not allege that a fee was paid for services regarding registration of the loan notes. Consequently, we reject Greenwich's claim that the plain language of the E&O Exclusion unambiguously bars coverage for all the *Hellum* claims.

In a related argument, Greenwich asserts that the "in connection with" phrase in the E&O Exclusion mandates the exclusion be interpreted broadly so as to exclude coverage even if Prosper performed services for others that were not the subject of the *Hellum* claims.[12] Greenwich argues that, pursuant to this broad interpretation of the E&O Exclusion, "liability claims that have *any* nexus to Prosper's provision of loan services to the [lenders] or to borrowers are barred." Even assuming that the phrase "in

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[12] The cases relied on by Greenwich to support this assertion are *Medill v. Westport Ins. Corp.* (2006) 143 Cal.App.4th 819, 830 [" 'California courts have consistently given a broad interpretation to the terms "arising out of" or "arising from" in various kinds of insurance provisions. . . .' [Citation.]"]; *Chrysler Motors v. Royal Indemnity Co.* (1946) 76 Cal.App.2d 785, 790 [where liability policy covered injuries caused by subcontractor's work but excluded liability for injuries caused by insured's employee "in connection with" subcontractor's work, court held exclusion applied because injury causing negligent act of insured's employee was in connection with subcontractor's work]; *Acadia Ins. Co. v. Vermont Mutual Ins. Co.* (2004) 2004 ME 121 [860 A.2d 390, 393] [where homeowner's liability policy excluded property damage "arising out of or in connection with" insured's business, court gave broad meaning to those terms in the employment context and held exclusion applied because fire occurred at insured's workplace]; *Metropolitan Property & Casualty Ins. Co. v. Fitchburg Mutual Ins. Co.* (2003) 58 Mass.App.Ct. 818 [793 N.E.2d 1252, 1255] [court interpreted "in connection with" and "arising out of" broadly and held business pursuits exclusion to homeowner's policy applied where alleged battery occurred at insured's place of employment]; *Nationwide Mutual Fire Ins. Co. v. Nunn* (1994) 114 N.C.App. 604 [442 S.E.2d 340, 344] [court interpreted "in connection with" broadly and held business pursuits exclusion to homeowner's policy applied where injury was connected to reception in the course of insured's business located in insured's home]; and *Professional Consultants Ins. Co. v. Employers Reinsurance Co.* (D.Vt., Mar. 8, 2006, No. 1:03-CV-216) 2006 WL751244 [p.*18; nonpub. opn.] [court determined " 'arises' out of" indicates a causal connection, and equated "related" to more broadly mean " 'in connection with,' 'associated with,' and 'with reference to' "]. None of these cases involves an E&O Exclusion to a D&O policy.

connection with" should be interpreted broadly, it would not cover all the *Hellum* claims. A contrary ruling would effectively vitiate the coverage provided by the D&O policy. (See *Hawaiian Electric, supra*, 1997 Lexis 24129 [p. *32-*33; nonpub. opn.] [broad reading of professional services exclusion in D&O policy would vitiate most of policy coverage]; *Tagged, Inc. v. Scottsdale Ins. Co.* (S.D.N.Y., May 27, 2011, Civ. No. JFM-11-127) 2011 WL 2748682 [p. *5; nonpub. opn.] [professional services exclusion in D&O section should not be read to vitiate D&O coverage]; *GeoStar, supra*, 2010 WL 845953 [p. *10] [same].)

As we noted previously, the D&O Part of the Policy provides coverage for claims for a "Wrongful Act" defined as "any actual or alleged act, error, omission, misstatement, misleading statement or breach of duty" by Prosper. Thus, to the extent the *Hellum* complaint alleged that Prosper committed a "Wrongful Act" by failing to properly perform its underwriting services, the E&O Exclusion would appear to apply. Any errors Prosper made would be "in connection with" the service it provided for a fee and, therefore, subject to the exclusion. But Greenwich's attempt to expand the exclusion to apply to all of the allegations made in the *Hellum* complaint overreaches. In the words of the trial court, "it loosen[s] the threshold requirement that Prosper must have performed services for others for a fee *that are the subject of the claims.*" (Italics added.) Effectively, it treats Prosper's entire online lending business as a service and any flawed business decision covered by the D&O Part as within the E&O exclusion. Such an overly broad interpretation is unreasonable.

B. *Sale of a Loan Note Is Not a Service*

Greenwich next contends that the E&O Exclusion bars coverage for *Hellum* because Prosper's "sale" of the loan notes was a "service" Prosper provided to borrowers and lenders, without which no loans would have been made. Greenwich relies on the following allegations of the SAC: Prosper connects borrowers who wish to borrow money with lenders who wish to commit to purchase loans in the form of loan notes that have been extended to borrowers. Potential lenders bid on funding loans for interest rates typically higher than those available at financial institutions. Following the auction

process, the borrower receives the loan either from Prosper or from a bank and the lender purchasing the loan receives an individual non-recourse promissory note. Prosper collects an origination fee from each borrower. Greenwich argues that Prosper's sale of the loan notes to the lenders provides a service to the lenders "by affording them an investment opportunity that they would not have otherwise had," for which the lenders paid loan servicing fees.

In support of the contention that "sale" of the notes is a "service," Greenwich relies on *Aetna Casualty & Surety Co. v. Dannenfeldt* (D.Ariz. 1991) 778 F.Supp. 484 (*Dannenfeldt*) and *Hollingsworth v. Commercial Union Ins. Co.* (1989) 208 Cal.App.3d 800 (*Hollingsworth*).

Dannenfeldt concerned an E&O professional services exclusion in a general liability policy. (*Dannenfeldt, supra,* 778 F.Supp. at pp. 488, 490.)[13] The numerous underlying actions against the insured alleged, inter alia, violations of federal securities statutes, federal and Arizona racketeering statutes, as well as conspiracy, fraud, and numerous other common law claims. (*Id.* at p. 489.) The gravamen of the underlying actions was that the insured was involved in a massive fraudulent scheme regarding the management of a savings and loan association and the sale of securities. (*Id.* at pp. 489-490, 495.) In particular, the underlying complaints alleged that the insured's securities salespeople, who were not licensed to sell securities, gave " ' "canned" ' presentation[s]" to potential securities purchasers during which they made various misrepresentations. (*Id.* at p. 495.) At issue on appeal was "whether a bond sales representative in a savings and loan new accounts department or teller window performs a professional service." (*Ibid.*) The court stated that in determining whether a particular act is a " 'professional service' " the act itself must not be viewed in isolation, but in the context of the business

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[13] The E&O exclusion in *Dannenfeldt* provided: " 'This policy does not apply to any liability for any actual or alleged: errors, . . . acts or omissions, . . . by the insured . . . arising out of the discharge of duties for professional services rendered or which should have been rendered in the conduct of the insured's operations.' " (*Dannenfeldt, supra,* 778 F.Supp. at p. 490.) "Professional services" was not defined in the policy.

or profession in which it was performed. (*Id.* at p. 496.) In concluding that the bond sales at issue were professional services, the court reasoned that the bond sales were the final link in a sophisticated marketing chain in which bonds were conceived, issued, and sold to the public through a savings and loan association. (*Id.* at pp. 496-497.)

Greenwich argues, like *Dannenfeldt*, Prosper's sale of securities was an inextricable part of a chain of events that included creating a marketplace for loans, connecting lenders and borrowers and issuing and distributing the loan notes. *Dannenfeldt* is factually distinguishable. In *Dannenfeldt*, the gravamen of the underlying actions was the insured's involvement in a fraudulent scheme regarding the management of a savings and loan association and the sale of securities. The gravamen of *Hellum* was Prosper's sale of unregistered securities; *Hellum* alleged neither fraud nor a fraudulent scheme which permeated Prosper's online lending business. Contrary to Greenwich's assertion, *Dannenfeldt* does not compel a conclusion that the "sale" of securities alleged here falls within the definition of "service" for purposes of the E&O Exclusion in the instant case.

Hollingsworth involved a professional services exclusion[14] in a merchants property and liability insurance policy issued for a cosmetics store. (*Hollingsworth, supra,* 208 Cal.App.3d at pp. 805, 808.) The underlying action against the insured alleged that the plaintiff was injured due to faulty ear piercing performed at the store by one of the insured's employees. (*Id.* at pp. 803-804.) In deciding that ear piercing constituted a professional service under the exclusion, the court concluded that a professional service "generally signifies an activity done for remuneration as distinguished from a mere pastime." (*Id.* at p. 807.) The court reasoned that in the context of a cosmetics business, the ear piercing performed in anticipation of some

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14 The professional services exclusion stated, " '[Insurer] does not insure you for bodily injury or property damage due to the providing of, or failure to provide, any professional service. However, this exclusion does not apply to pharmacological services if you are doing business as a retail drugstore.' " (*Hollingsworth, supra,* 208 Cal.App.3d at p. 803.) "Professional services" was not defined in the policy.

financial gain constituted a professional service. (*Id.* at pp. 808-809.) *Hollingsworth* did not concern whether the ear piercing constituted a sale rather than a service and its determination that a particular activity constituted a "professional service" is unhelpful in resolving the issue here.

Since the term "services" is not defined in the Policy, we consider its dictionary definition. (*Scott, supra*, 44 Cal.App.4th at p. 29.) "Service" is defined, in relevant part, as "[t]he act of doing something useful for a person or company, [usually] for a fee." (Black's Law Dict. (9th ed. 2009) p. 1491, col. 2.) "Sale" is defined, in relevant part, as "the transfer of property or title for a price." (Black's Law Dict., *supra,* at p. 1454, col. 1.) Greenwich argues that the broad definition of "service" covers the definition of "sale." Even if this is a reasonable interpretation of "service," a reasonable insured could interpret that word to exclude sale, and any ambiguity is resolved in favor of Prosper. (See *NABM, supra,* 137 Cal.App.4th at p. 642; *Morris, supra,* 84 Cal.App.4th at p. 1029.)

We recognize that courts have rejected the notion that to avoid ambiguity, an insurer must define ordinary terms in its policy. (See *Bay Cities Paving & Grading, Inc. v. Lawyers' Mutual Ins. Co.* (1993) 5 Cal.4th 854, 866 [lack of a policy definition does not necessarily create ambiguity].) Greenwich contends "service" is such a term. But the general rule provides little comfort to Greenwich. The ambiguity as to whether Prosper's sale of the loan notes constitutes a service is heightened by the fact that the term "sales" is not included in the E&O Exclusion, but is included in the securities exclusion (see fn. 7, *ante*, p. 6), which refers to the "sale" of securities. This suggests that Greenwich intended the terms "sales" and "services" to have different meanings. In addition, since the Policy contains both exclusions, Prosper could reasonably expect that claims like those in *Hellum* regarding sale of the notes as securities would fall within the more narrowly worded securities exclusion, and not within the more broadly worded E&O Exclusion, which does not refer to a sale of securities. Greenwich could have, but failed to plainly, clearly, and unambiguously state that claims arising from sales of the loan notes are excluded from coverage under the E&O Exclusion. The ambiguity must be resolved in favor of Prosper and against Greenwich.

C. *Failing to Register the Loan Notes as Securities Does Not Trigger the Exclusion*

Finally, Greenwich asserts the E&O Exclusion applies because Prosper's failure to register the loan notes as securities constituted a failure to provide a service for which it received a fee. Greenwich cites *Security and Exchange Com. v. M & A West Inc.* (9th Cir. 2008) 538 F.3d 1043, 1053, for the proposition that the purpose of the securities registration requirement is " 'to protect investors by promoting full disclosure of information thought necessary to informed investment decisions.' [Citation.]" (Accord, *People v. Park* (1978) 87 Cal.App.3d 550, 565 ["[T]he main objective of the securities law is to protect the public against the imposition of insubstantial, unlawful and fraudulent stock and investment schemes [citations], and to promote full disclosure of all information that is necessary to make informed and intelligent investment decisions [citations]."].)

Greenwich argues that registration of the loan notes would have constituted a service to the loan note purchasers (lenders) because it would have provided them with material information; and, absent such registration, issuance of the loan notes was unlawful. As support, Greenwich relies on paragraph 44 of the *Hellum* SAC, which provides: "Prosper controlled and provided information to prospective lenders about loan note listings to enable lenders to make informed business decisions. Such information ranged from credit ratings, debt to income ratios, delinquency activity, and certain matrixes on the Website to gauge potential returns and historical loan performance. The information Prosper provided to prospective loan note purchasers, however, was insufficient for the purposes for which it was offered and did not include important disclosures that were required in order to offer and sell the loan notes [as] securities."[15]

Greenwich additionally argues that Prosper's failure to register the loan notes as securities was also a failure to perform a service for the *borrowers*. It notes that the

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[15] As noted earlier, Prosper's alleged failure to provide adequate information to the loan purchasers may be a claim excluded by the E&O Exclusion, but this does not establish that all the claims made in *Hellum* are excluded.

Hellum SAC alleges that Prosper collected "underwriting fees from each borrower" of a percentage of the loan proceeds for Prosper's "underwriting services," for services Prosper provided prior to the sale of the loan notes. Greenwich asserts, since the borrowers were dependent on Prosper to ensure the loan transactions complied with applicable laws, Prosper's alleged failure to register the loan notes constituted a failure to perform a service to others.

Greenwich's argument fails because there is no allegation in the *Hellum* original complaint or SAC and no extrinsic evidence establishing that Prosper agreed to register the loan notes for the lenders and borrowers; that the lenders and/or the borrowers agreed to pay Prosper a fee for registration of the loan notes; or that the fees paid by the lenders and borrowers were for registration of the loan notes.

Greenwich asserts that registration of the loan notes would have constituted a service performed for the borrowers and the lenders for a fee because the borrowers paid origination fees and the lenders paid servicing fees. Greenwich argues that under the plain language of the E&O Exclusion, neither the source, nor the recipient of the fees is determinative so long as the service is performed for a fee or other compensation. In support of this assertion it cites *Argentinian Recovery Co., LLC v. Bd. of Directors of Multicanal* (Bankr. S.D.N.Y. 2005) 331 B.R. 537, 545 [under federal securities law, issuer of securities as well as its underwriters, accountants, lawyers, and controlling individuals can be liable for fraudulent disclosures in a registration statement]; *In re Worldcom, Inc. Securities Litigation* (2004 S.D.N.Y.) 346 F.Supp.2d 628, 636-637 [investment banks that underwrote bond offerings potentially liable for securities registration violations]; and *In re Am. Continental Corp./Lincoln Savings & Loan Securities Litigation* (D.Ariz. 1992) 794 F.Supp. 1424, 1452-1453 [attorney who provides legal opinion used in connection with an SEC registration statement can be held liable under the Racketeer Influenced and Corrupt Organizations Act (18 U.S.C. § 1961 et seq.) and for securities registration violations and common law fraud]. However, for purposes of an E&O exclusion to a D&O policy, these cases do not establish that

registration of a loan note is a service performed for the purchaser or borrower prior to sale of the note.

Similarly, Greenwich argues "the E&O Exclusion is triggered whenever a claim arises out of services provided for others for compensation, regardless of whether the claimant is the individual or entity that received or paid for the services." In support, it cites numerous cases which hold that professional services exclusions can bar coverage for claims brought by parties other than the insured's clients. (See *Harad v. Aetna Casualty & Surety Co.* (3d Cir. 1988) 839 F.2d 979; *Vogelsang v. Allstate Ins. Co.* (S.D.Fla. 1999) 46 F.Supp.2d 1319; *Erie Ins. Group v. Alliance Environmental, Inc.* (S.D.Ind. 1996) 921 F.Supp. 537; *Pekin Ins. Co. v. L.J. Shaw & Co.* (1997) 291 Ill.App.3d 888 [684 N.E.2d 853]; *Tri-Etch, Inc. v. Cincinnati Ins. Co.* (Ind. 2009) 909 N.E.2d 997; and *Boggs v. Camden-Clark Memorial Hospital Corp.* (2010) 225 W.Va. 300 [693 S.E.2d 53].) However, these cases do not consider an exclusion like the E&O Exclusion at issue here. Nor do these cases suggest that a claim for failing to register securities would be covered by this E&O Exclusion.

We conclude that Greenwich has not met its burden of establishing that all of the claims in *Hellum* fall within the Policy's E&O Exclusion and, therefore, the E&O Exclusion does not relieve Greenwich of its duty to defend Prosper.

DISPOSITION

The stipulated final judgment is affirmed. Costs on appeal to Prosper.

SIMONS, Acting P.J.

We concur.

NEEDHAM, J.

BRUINIERS, J.